Executive Summary
Independent Review Committee
October 2004

Introduction/Purpose

The purpose of the Report is to provide foundational information to assist the Independent Review Committee understand the history and the potential of trust land management in this century. History has given us much. Land...Laws...Institutional capacity. And the trusts have produced billions of non-tax dollars used to build elementary schools, institutions of higher learning and help fund counties over the years. This incredible endowment of productive lands can provide such direct and many indirect benefits well into the future. But the costs to obtain those benefits will be greater relative to the revenue they produce than in the past.

Given our best projections of revenue, and our best analysis of future costs to manage the trusts, the Department of Natural Resources has reached the conclusion that it will take additional resources beyond what will be available under the current funding mechanism to achieve the full potential benefits expected from our State Trust Lands. Under the assumption that the current legal and contractual framework for land management remains constant, the focus of the Independent Review Committee is to test that hypothesis, and evaluate the effectiveness and efficiency of trust land management.

The expected outcome is a December 2004 Final Report to the Commissioner of Public Lands. It is anticipated that the Report will contain both findings of fact and recommendations on effectiveness and efficiency and alternative funding mechanism that will help the Commissioner of Public Lands in framing options for the trustee, the Legislature.

Public Policy Context

When Washington entered the Union as a state in 1889, it was granted 3.2 million acres of land by the federal government to help establish and maintain institutions important for the new state. Unlike most states, Washington public policy fairly quickly evolved into "retain the land in trust ownership." This forward-looking stance preserved options for today and future generations to provide sustainable benefits from these lands.

The State's underlying policy of "retain the land in trust ownership" remains the fundamental policy today. However, much has changed since statehood. Our population has substantially increased. Science and technology have increased our understanding of what it takes to provide the important economic benefits, while ensuring good stewardship of the lands and resources well into the future.

As our knowledge has grown, the concept of stewardship has evolved in our laws and public policies. The concept of harvesting a sustained yield of timber became law for the trusts in 1971, but was preceded by public concerns in the 1920's as increasingly cut-over lands were left unproductive and became tax delinquent. In 1957, the Department of Natural Resources was created to provide professional forestry management on trust lands, and focus on providing school construction financing for the growing population. The State Environmental Policy Act (SEPA) was passed in 1971. Later in the 1970's the SEPA process was applied to state timber sales , adding a public process to analyze environmental impacts in timber sales design. The Multiple Use Act was also passed in 1971, ensuring access to trust lands for a variety of recreational uses when consistent with the underlying trust responsibility. In 1974 the modern Forest Practices Act was adopted, and the balance between state, tribal, and environmental interests has been continued to be debated during the following three decades. More recently, endangered species listings led to the State's Forest and Fish Agreement which was became law for all forest landowners, and DNR adopted it's Habitat Conservation Plan (HCP) on trust lands. The HCP is an "insurance policy" to provide certainty and predictability for maintaining revenue flow to the beneficiaries while meeting important conservation objectives required under the Endangered Species Act.

Public policy regarding trust land management has evolved in complexity throughout its 115-year history. The results are now substantial financial and environmental benefits from active trust land management. We now have a better understanding of the connections between our past practices and what we need to do today. Today, we know that thinning overstocked stands improves forest health while accelerating useable habitat and reduces fire danger. And the Forest Practices Act requires investments to fix roads and replace culverts that limit fish passage.

As science and technology have given us new knowledge and tools to meet a variety of important goals for our trust lands, the complexity of management and cost of production have increased significantly.

Costs and Benefits

Scientifically based, active land management has substantial benefits, but also costs. The central question of this report, is how to pay for the benefits while continuing to provide substantial financial support to the beneficiaries. This is an ongoing question.

The information that follows is shown in real (2003) dollars; this means, that the values are adjusted to the purchasing power of today's dollar. This is relevant in that both costs and revenues vary due to inflationary pressures. Much of the data will show trends over three plus decades to help understand macro-economic and other trends that strongly influence land management.

Benefits for the Trusts

Macro-economic forces of supply and demand have converged to change the long-term trends in commodities, both timber and agricultural. Until the mid 1990s, real timber prices have shown real price appreciation over time, despite numerous ups and downs. During the past 10 years, real prices have trended downward, and starting at this new lower level they are forecast to remain stable in real terms for the foreseeable future. Increases in demand are offset by increases in supply due to expanding supply from forests around the world. Timber prices averaged $273 MMBF in the last biennium. That average sales price was 56% lower than 1993-95 and 41% lower than the 1971-73 timber sales prices, in real terms. While the department has consistently increased revenue from non-timber sources, revenue from timber still represents about 85% of the total revenue. Timber is expected to continue to be the major revenue source for the foreseeable future.

The department has made many changes in how timber is marketed, including shortening sales contract length, increased pole sales, managing the timing of wood flow to the market, and contract harvesting a different product mix. The result is about a twenty percent higher sales prices for timber. The department has also increased efforts to diversify trust assets into commercial and agricultural lands, seeking to sell or transfer unproductive land assets, and acquire immediate revenue and long-term value improvement. In the past year alone, real revenue to the common schools was improved through specific land transactions. Prior to asset re-positioning, $16.6 million worth of property returned only $3,000; after re-investing $10.4 million of the original $16.6 million, annual returns were of $771,000. Through these transactions, returns are increased from less than 1 percent on the properties disposed to 7.4 percent return on the newly acquired properties.

Costs of business

Recognizing the significance of long-term revenue trends and the concurrently significant increases in costs for staffing, fuel, and infrastructure, the department has taken dramatic steps to reduce costs and increase productivity over the past four years. DNR has eliminated more than two hundred positions since 2001, and reduced administrative services FTEs by 14 percent. By organizing to focus staff on specific tasks with measurable goals, we have increased timber sales labor productivity by 40%. Even with the today's increased complexity of forest management and the increased cost of doing business, DNR's expenditures last biennium (2001-03) are at the lowest point since 1971-73 biennium, in real terms. In spite of these dramatic reductions, costs have continued to exceed revenue into the management funds (Resource Management Cost Account (RMCA) and Forest Development Account (FDA)). Since the 1991-93 biennium, costs have exceeded revenue in 5 of the past 6 biennial periods.

Management Fund Balances Continue to Decline

Despite the department's efforts to reduce costs and enhance revenues, management fund have declined faster than the department has been able to reduce costs. Since 1997, trust land management costs were 28% of gross revenue while management fund revenues are generated at 24%. Without further action, expenditures are expected to continue to exceed revenues for the foreseeable future. If left unchecked, fund balances will soon evaporate.

On September 6, 2004, the Board of Natural Resources selected a decadal sustainable harvest level that included new forest management strategies, which would realize higher net revenue to the beneficiaries while improving forest health. Given the current trends in revenue, cost, and management fund balance, it will take an additional investment to realize the full ecological and revenue potential. Gross revenue could increase to some $2.3 billion over the decade. In addition, older forest habitat could increase five-fold, acres of unhealthy forests could decrease by 10%, standing forest inventory could increase by 45%, and about 2,000 jobs could be created. These gains in revenue, ecological and other benefits cannot be achieved unless the funding problem is addressed.

Conclusion

In early 2001, Commissioner Sutherland promised the legislature that he would exhaust all options for efficiency and effectiveness in the agency, before he would consider asking for help. Throughout the ensuing four years, significant cost savings, substantial productivity gains and numerous revenue enhancements have been achieved throughout the agency. Despite these efforts, the department's analysis shows that without some source of additional investment dollars, the funds will be exhausted within a two and six years for the RMCA and FDA, respectively.

This report launches an independent review of that analysis and asks for your recommendations regarding the issues.